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Supreme Court of the United States

OCTOBER TERM, 1936.

No. 260.

IN THE MATTER

OF

UNITED CIGAR STORES COMPANY OF AMERICA,
Debtor.

CITY BANK FARMERS TRUST COMPANY, assignee of FLORENCE H. BUGBEE,
Petitioner,

against

IRVING TRUST COMPANY, as trustee of the estate of the above-named Debtor, et al.,
Respondents.

BRIEF ON BEHALF OF RESPONDENT, PREFERRED STOCKHOLDERS PROTECTIVE COMMITTEE.

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Opinions Below.

The opinion below is reported in 83 F. (2d) 209. The District Court's opinion appears in the record at page 49; the Special Master's opinion appears in the record at page 37.

Statement of the Case.

The facts are as follows: On August 29, 1932, the Debtor was adjudged a bankrupt. It was then the lessee of premises in Trenton, New Jersey, under a lease from Mrs. Florence H. Bugbee, the Petitioner's assignor. The premises were occupied by several sub-tenants of the Debtor (R. 20). On November 15, 1932, following notice from the Debtor's trustee in bankruptcy that it would not assume the lease, Mrs. Bugbee re-entered the premises, made a lease of a portion of the premises to a new tenant, relet other portions of the premises to persons who had been, till that time, sub-tenants of the Debtor, and subsequently made other leases (R. 33-35). The acts of the landlord upon and following reentry, the courts below have held, evidenced her acceptance of surrender of the lease and termination of the Debtor's liability thereunder (R. 42, 50, 73).

On June 9, 1934, the Debtor instituted the present proceedings by filing its petition under Section 77-B of the Bankruptcy Act. Petitioner thereupon filed a claim alleging damages for the rejection of the lease in 1932.

The Special Master, the District Court and the Circuit Court have held that the Petitioner has no standing as a creditor in these proceedings. The Petitioner appeals from the disallowance of its claim.

The Statute.

Section 77-B, subdivision (b) (10), of the Bankruptcy Act, so far as material, reads as follows:

> "The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property, including claims under executory contracts whether or not such claims would otherwise constitute provable claims under this Act. * * *
>
> "In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this

section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity, in a proceeding pending prior to the institution of a proceeding under this section, any person injured by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor. The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63 (a) of this Act, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of re-entry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or re-entry."

Summary of Argument.

This brief will be confined to answering the principal point urged by Petitioner, to wit, that its assignor has a valid claim, under such statute, for injury arising from "rejection" of the lease by the Debtor's trustee in bankruptcy, notwithstanding that she may have terminated the Debtor's liability following such rejection and long before the statute was enacted.

I.

Section 77-B makes no provision for the allowance of claims based on rejection of leases under which the debtor's liability had ceased prior to the enactment of the statute.

The history and language of the statute do not, we submit, disclose a purpose upon the part of Congress to confer a creditor status upon anyone who has released his claim against the debtor or otherwise terminated the debtor's liability to him.

It is clear from an examination of the Congressional debates and committee reports that it was the intention of Congress to recognize, for the purposes of a reorganization under the Act, certain actual legal claims which had not been previously "provable" in bankruptcy because they were contingent claims or had not come into existence at the time of the bankruptcy adjudication. The principal purpose of the legislation was to provide an instrumentality for speedy reorganization of financially embarrassed corporations and to prevent unreasonable minorities from blocking fair and equitable plans of reorganization. To accomplish the desired purpose Congress extended the doctrine of composition provided for in Section 12 of the Bankruptcy Act passed in 1898. *Downtown Inv. Assn.* v. *Boston Met. Bldgs., Inc.*, (C. C. A. 1) 81 F. (2d) 314.

None of the bills introduced to provide for the reorganization of private corporations preceding H. R. 5884, which became Sections 77-A and 77-B, except H. R. 5009, throw any special light upon the matter. They indicate no purpose, however, to recognize as creditors persons who are not creditors.

H. R. 5884, as passed by the House, contained the following provisions [Sec. 79 (b) (10)]:

> "* * * The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property, including claims under executory contracts and for future rent, whether or not such claims would otherwise constitute provable claims under this Act.
>
> "In case any executory contract shall be rejected, the same shall be deemed to have been breached and the holder shall be entitled to file a claim for damages for such breach and such claim may be allowed provided such contract shall not have been terminated by forfeiture, re-entry or otherwise."

H. R. 5009 contained similar provisions.

After H. R. 5884 had passed the House, and when it was before the Senate, the first clause quoted above was amended

by the omission of the words "and for future rent." This was Senate Amendment 13. And the clause with respect to the effect of rejection of executory contracts was amended to read as follows:

> "In case any executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee in bankruptcy or receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, any person injured by such rejection shall for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor to the extent of the injury resulting from such rejection: Provided, That the claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall not be treated as a claim ranking on a parity with debts which would be provable under section 63(a) of this Act, except up to any amount equal to the rent reserved by said lease for the year next succeeding the date of the order approving the petition or answer under this section plus an amount equal to the unpaid rent accrued up to said date, but the balance, if any, of such claim shall be subordinated in rank to debts so provable."

This was Senate Amendment 14. Both amendments were offered from the floor without explanation, and were adopted without debate.

Subsequently, in conference, the clause quoted above as Senate Amendment 14 was further amended to the form in which it appears in Section 77-B (House Report No. 1821, 73d Congress, 2d Session). As the reason for the amendments was not stated, we are confined to consideration of the language of the two clauses.

The statute was amplified to compensate a landlord whose lease has been rejected in a prior proceeding. But both provisions are conditional upon injury, the substituted provision, as well as the original provision, plainly implying that a claim resting on rejection shall be subject to legal defenses.

The condition attached to the original provision was imperfectly expressed as is pointed out in the brief of the Trustee. The condition expressed in the substituted provision by the word "injured" is precise if given its legal connotation.

Congress knew that the affairs of corporations that might desire to reorganize under the new statute were being administered in equity receivership proceedings in state and federal courts and in bankruptcy proceedings. Leases had been disaffirmed in many of these proceedings; and many of the landlords whose leases had been so rejected had not terminated the liability of their landlords under their leases although they had repossessed themselves of their properties. Various devices were adopted to keep alive the leases or the liability of the bankrupt tenant.* Leases disaffirmed in such a prior proceeding but kept alive would, presumably, be considered burdensome assets in a proceeding under Section 77-B. Congress, accordingly, indicated that another disaffirmance of such leases would be unnecessary in the new proceeding. It was proper that such landlords, whose rights against the Debtor would be terminated in the reorganization, as well as landlords with surviving covenants for damages or indemnity and landlords whose leases would be expressly rejected in the reorganization proceeding itself, should be treated as creditors under the new law.

The Petitioner further suggests that liability on such claims as the Petitioner's is the price to be paid by the Debtor for the benefits conferred by the Reorganization Act and its release from the old bankruptcy proceeding, and that the Debtor assumed liability for all rejections of leases in the bankruptcy proceeding by filing its petition for relief under Section 77-B. Petitioner fails to take into consideration that the reorganization proceedings might have been instituted by the Debtor's creditors, and that the creditor status of a landlord does not depend upon any distinction as to how the proceedings are instituted, or upon whether the prior proceeding was a state or federal equity receivership, or a federal bankruptcy proceeding.

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* Concededly, the Petitioner's assignor might have kept alive the liability of the Debtor by simply notifying the Debtor that she would re-enter and re-rent for its account.

The Petitioner's argument also overlooks the consequences of the construction which it urges. Not only would the *debtor's* burdens be added to; actual creditors of the debtor would be penalized. We question whether any plan can be said to be fair and equitable and not unfairly discriminatory against any class of creditors or stockholders if that plan makes substantial provision for parties who have no claims at law or in equity against the debtor.

The Petitioner and other claimants with similar interests urge that the decision in the *Kuehner* case, 85 F. (2d) 35, is inconsistent with the determination of the Circuit Court in the instant case. We see no such inconsistency. It is our understanding that the distinction, by reason of which the claim in the *Kuehner* case was allowed, was that the claimants there were "creditors," as such word is defined in Section 77-B, and that it was the intention of Congress that compensation should be awarded for the termination of their contract right. We have no doubt but that Congress may require the liquidation of a contract right in a reorganization proceeding under Section 77-B, recognizing the right, though no action could at the time be maintained on the contract in a state or federal court. This was the situation before the Court in *Hermitage* v. *Levine*, 248 N. Y. 333. We do doubt the power of Congress, retroactively, to provide that rejection of a lease in a prior proceeding shall give rise to a liability where all liability on the lease has been terminated.

Summarized, the Petitioner's contentions are that the language of Section 77-B with respect to claims is to be interpreted without regard to the normal meanings attributed at law to the words "damages" and "injury"; and that since no defenses are mentioned in Section 77-B, no defenses should be allowed.

We submit that Section 77-B must be interpreted against the background of existing law; that the word "damages" cannot mean other than "legal damages"; that the word "injury" cannot mean other than "legal injury"; and that defenses, existing at law and in equity, should be available in reorganization proceedings, as they always have been against claims in bankruptcy.

CONCLUSION.

The order appealed from should be affirmed.

Respectfully submitted,

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